ECONOMY

The myth of abundance puts jobs in peril

Think Strategically: Democracy in Peril

Growing Economy, Positive Consumer Sentiment Not Enough To Stave Off Hostile Trade Wars; Construction Workers' at $15 an Hour Creates Ripple Effect

BY FRANCISCO RODRÍGUEZ-CASTRO
frc@birlingcapital.com

The Week in the Markets: Trade Wars, Social Security and Medicare funding

Last week the market indicators closed in negative territory, with the Dow Jones Industrial Average standing at 25,916.54, or a loss of 48.28 for the week. The S&P 500 closed at 2,871.68, or a loss of 29.84 for the week, and the Nasdaq closed at 7,902.59, a loss of 207 for the week. U.S. big-cap stocks lost north of 1 percent for the first time in eight weeks, adding to the most significant decline in value of the technology-driven Nasdaq, which closed with its worst week in more than five months. The market absorbed the strong jobs-growth report that added more than 200,000 new jobs, with salaries and wages increasing at the fastest clip since 2009. However, it was not enough to dismiss the increasingly hostile trade tensions that the Trump administration has brought about by challenging the status quo on trade. A growing economy and positive consumer sentiment are not enough to stave off the increasingly hostile trade wars.

Trade issues have been front-page news for most of the year. The effects of the imposition of tariffs will continue to impact markets and will cause increased volatility.

One such example is the ongoing North American Free Trade Agreement (Nafta) negotiations, and as we reported, Mexico and the U.S. have agreed to implement a new trilateral agreement. We estimate Canada will soon agree and approve the new deal, and the legislative bodies of all three Nafta countries must approve the deal. It remains to be seen how this will play with the U.S. Congress, which by then will have felt the impact of the midterm elections.

The ongoing China-U.S. tariffs war continues to impact hundreds of products, with many trade experts pointing to an additional round of tariffs totaling $200 billion on Chinese exports.

We see continued volatility in the markets and investors must implement defensive stock strategies to alleviate the effect.

Social Security, Medicare: Running out of time, funding

Once a year, the Social Security and Medicare trust funds report their current and projected financial status.

Both Social Security and Medicare are facing short- and long-term financing shortfalls under currently scheduled benefits and financing. Congress must act to reduce any possibility of financing shortfalls to the programs. Social Security and Medicare account for 42 percent of federal program expenditures and will experience increases in cost growth at a substantially more rapid rate than gross domestic product (GDP) growth through the mid-2030s.

Social Security

The program provides workers and their families retirement, disability and survivors insurance benefits. Over the program's 83-year history, it has collected about $20.9 trillion and paid out $18.0 trillion, leaving asset reserves of $2.9 trillion at the end of 2017 in its two trust funds.

The Old-Age & Survivors Insurance (OASI) Trust Fund pays retirement and survivors benefits, and the Disability Insurance (DI) Trust Fund pays disability benefits.

The combined trust funds will be depleted in 2034.

Social Security's total cost is projected to exceed its total income (including interest) in 2018 for the first time since 1982, and to remain higher (in costs) throughout the projection period.

Medicare

The program has two trust funds, the Hospital Insurance (HI) Trust Fund and the Supplementary Medical Insurance (SMI) Trust Fund. HI, known as Medicare Part A, helps pay for hospital, home health services following hospital stays, skilled nursing facility and hospice care for the aged and disabled. SMI consists of separate accounts for Medicare Part B and Part D. Part B helps pay for physician, outpatient hospital, home health and other services for the aged and disabled who have voluntarily enrolled. Part D provides subsidized access to drug insurance coverage, and it is now projected that the HI Trust Fund will be depleted in 2026.

Final Word—Democracy In Peril: Construction Workers Executive Order

A recent Governor's Executive Order to increase the minimum wage for construction workers to $15 an hour at the lowest base level produces a cascade effect in all other payroll levels and industries closely related to the construction sector. This Executive Order, arbitrarily presented together with the Laborers International Union of North America (aka LiUNA), increases by more than 85 percent the average labor costs of any government construction project.

Pre-Hurricane Maria construction contracts are already experiencing increased labor and material costs due to resource constraints brought on by all the reconstruction work. Considering that anywhere from 25 percent to 35 percent of a business' typical project cost goes toward payroll, this increase alone can represent up to 25 percent, if not more, of total construction cost. With blatant disregard for existing contracts, this Executive Order can quickly turn profit into significant losses. Project owners of ongoing contracts that cannot absorb these increases will have to consider changing the outcome without impairing essential functions or characteristics of their projects, or else face canceling their contracts. Future private and federal projects working within budget constraints will have to see if it is still feasible to move forward. In all, fewer projects will be built, putting fewer construction workers on the job.

According to the Builders Association, the cost of benefits and mandatory payments associated with construction salaries add about 40 percent to hourly labor costs. In other words, if an employee earned $8.25 an hour, the employer incurs $3.30 in additional costs per hour for mandatory benefits and payments (for a total of $11.55 an hour). Therefore, the mandated $15-an-hour salary rate will cause a total hourly rate expense, including these additional costs, of $21 per hour.

The Planning Board in its 2017 Economic Report to the Governor cites a 2016 study by Hernández et al., where it concludes an increase to the minimum wage above $10 an hour will result in 128,000 jobs being lost. In addition, if the minimum wage is increased, the manufacturing, finance, services and public administration sectors would also sustain job reductions.

Payroll increases should follow a growing economy, not the other way around.

The Governor forgets that more than 500 contractors went bankrupt for lack of work during the past few years and now, facing the opportunity to restore the sector and produce a new crop of construction entrepreneurs, the Government takes an antidemocratic action and arbitrarily increases the cost of all construction projects.

The Financial Oversight & Management Board (FOMB) has advised the Government, but this is not enough. The Certified Fiscal Plan does not contemplate this cost to the economy and damages any recovery of the local construction sector. In our research, we only found one person who lauded this Executive Order, and that was from the head of LiUNA. These types of political shenanigans have made the Government not only complicit in the fiscal imprudence, but also adds the element of pleasing a national union at the detriment of local contractors, which in turn puts our Democracy in Peril.

These maneuvers are unacceptable and unfair, and the Executive Order should be rescinded.

Every worker deserves the best possible wage. However, changes cannot be imposed through an ambush.

Furthermore, the mere fact of having a union with the Governor when the Executive Order was signed removes any legitimacy from the process since it gives the impression that the Government was sold to the highest bidder.

Francisco Rodríguez-Castro, president & CEO of Birling Capital, has more than 25 years of experience working with government, and multinational and public companies.